U.S. Senate
Republican Policy
Committee

Legislative Notice

Jon Kyl, Chairman

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S. 1751 – Class Action Fairness Act of 2003

Calendar No. 315

The Class Action Fairness Act (then S. 274) was reported favorably with an amendment by the Judiciary Committee on June 2, 2003, by a bipartisan vote of 12-7. (Voting nay: Senators Leahy, Kennedy, Biden, Durbin, Feingold, Schumer, and Edwards.) S. Rept. 108-123; minority views filed.

Senator Grassley introduced S. 1751 on October 17 — the same bill as S. 274 with a bipartisan change discussed herein. S. 1751 was read twice and placed on the Senate Calendar.

Noteworthy

- On October 17, the Majority Leader asked for unanimous consent to bring up S. 274 and substitute the text with S. 1751, so that the text considered on the floor would include a bipartisan agreed-upon modification. Democrats objected to the consent request, and the Leader was forced to bring up S. 1751 under Rule 14 and move to proceed to its consideration.
- At the Committee markup for S. 274, a section dealing with "mass actions" — devices used by some States that are roughly parallel to class actions — was stripped on the condition that it would be modified and put back into the bill before floor consideration. Pursuant to that earlier agreement, Senators Hatch, Grassley, Specter, Kohl, and Feinstein since have agreed to the modified language and replaced it in Section 4 of the bill. The modified language was wrapped into the Committee-reported bill and introduced as S. 1751.
- S. 1751 addresses the problems exposed by the explosion of class action litigation nationwide over the past 20 years, during which some attorneys have abused class action procedures, resulting in an enormous adverse impact on consumers, the economy, and the courts.
- The bill creates a consumer bill of rights that mandates better information about the rights of class members and imposes stricter scrutiny of proposed settlements.
- S. 1751 corrects a loophole in the federal diversity jurisdiction rules to ensure that federal courts, rather than state courts, hear lawsuits that are truly national or interstate in scope.
- A similar bill, H.R. 1115, passed the House on June 12, 2003, by a vote of 253-170.

Highlights

- *First*, the bill creates a consumer bill of rights to protect federal class action plaintiffs from collusive and unfair settlements. The bill of rights will:
  - — Ensure that class action plaintiffs receive clear and effective notice of all settlements and are informed of their rights to object to unfair terms;
  - — Require courts to scrutinize closely proposed settlements, especially where plaintiffs receive only "coupons" while class counsel receive large fee awards;
  - — Prevent "bounty payments" to some class members at the expense of others;
  - — Prohibit settlements in which "recovering" plaintiffs are forced to *pay* money to class counsel unless the court finds that the arrangement has substantial benefits to the class members that outweigh the monetary loss; and
  - — Require notice to state officials to enable them to protect their citizens' interests.
- *Second*, the bill corrects a flaw in the current diversity jurisdiction statute that severely restricts interstate class actions from being heard in federal courts. The bill therefore:
  - — Provides for original federal jurisdiction where defendants are sued outside their home State, the amount in controversy exceeds $5 million, at least 100 putative class members sue, and citizens of different States are on opposing sides; but
  - — Gives federal courts discretion to refuse jurisdiction where five enumerated factors favor state adjudication.
- *Third*, the bill directs the Judicial Conference of the United States to prepare a report with recommendations on best practices for managing class actions and awarding appropriate attorneys fees.

Background

Class action lawsuits allow plaintiffs whose injuries might not be worth enough to justify bringing individual suits to combine their claims into one lawsuit against a common defendant. In recent years, however, a relatively small number of class action plaintiffs' attorneys have abused the class action procedures. The effects have been dramatic: a distortion of our federalist system by the actions of a few rogue state courts; excessive attorney fee awards at the expense of injured plaintiffs; unprecedented costs to the national economy; and an overall decline in public respect for our nation's judicial system.

The Loophole in Federal Court Jurisdiction Rules for Multi-State Class Actions. The U.S. Constitution provides for federal jurisdiction over all lawsuits between citizens of different states, i.e., those cases where the parties are of "diverse" citizenship. Today, the most obviously "national" types of litigation — multi-million-dollar class action lawsuits involving national companies engaging in interstate commerce with citizens of many states — are often stuck in state court. This is so because *Congress* has narrowly construed constitutional diversity to require "complete diversity" — requiring *all* plaintiffs to be diverse from *all* defendants. Consequently, national class actions with plaintiffs from all 50 states and defendants from

multiple states are rarely eligible for federal court. The current rules allow lawyers to game the system and direct their claims to certain state courts. The result of this forum shopping is that a few state courts effectively regulate national industries and professions beyond state borders.

The Constitution provides for federal jurisdiction over cases between citizens of different states precisely so that parties never have to deal with questions of local bias. The Senate need not pass judgment on the quality of state court judges — most of whom are undoubtedly of high integrity and competence — to recognize that national, multi-state class actions should not be barred from the federal courts. However, Congress must change the diversity rules to ensure national class actions are heard in their proper forum — federal court.

The Growing Abuse of Coercive Interstate Class Actions. A lawyer-driven class action industry devoted to finding opportunities to extract financial payments from American business has developed in the past few decades. A focused group of attorneys "shop" throughout the nation for the friendliest courts to hear possible cases, dragging interstate businesses into carefully-chosen state courts where judges hastily certify classes without regard to Due Process concerns and where juries are known to render extravagant awards. Many of these lawsuits implicate citizens of many states and involve interstate commerce — precisely the kinds of lawsuits better suited to the federal courts. One study estimates that virtually every sector of the United States economy is on trial in *only three counties* (Madison County, Ill.; Palm Beach County, Fla.; and Jefferson County, Tex.), including long-distance carriers, gasoline purchasers, insurance companies, computer manufacturers, and pharmaceutical developers.

Current Class Action Abuses Continue to Harm Plaintiffs. Injured plaintiffs are suffering due to weak state court oversight of class action lawsuits. As a result of lax supervision, the legal system returns less than 50 cents on the dollar to the people it is designed to help, and only 22 cents to compensate for actual economic loss.

Many settlements consist of extravagant payments to plaintiffs' attorneys and nothing of real value to the injured plaintiffs. For example, in a case against Blockbuster, Inc., customers who alleged they were charged excessive late fees for video rentals were to receive $1 coupons while their attorneys received over $9 million. In an Illinois case about cellular phone charges, settling class members received coupons to buy future products, while their attorneys received more that $1 million in fees. In a similar "coupon" case settlement in California, class members received a $13 rebate towards the purchase of new computer monitors, while their attorneys received $6 million. These coupon settlements represent a boon to plaintiffs attorneys (who receive the bulk of the benefit) and defendant companies (because coupons are rarely redeemed).

Injured plaintiffs also suffer when they receive complicated settlement notices that fail to explain clearly their right to challenge the settlement or to enjoy its full benefits. Also troubling are settlements crafted to provide very large payments to the original "named" plaintiff in order to persuade that plaintiff to agree to a settlement that will give fellow class members far less compensation (if any).

The Costs of Runaway Litigation to the National Economy. Over the past decade, class action lawsuits have grown by over 1,000 percent nationwide. These increased claims inevitably produce hasty, unjust settlements. This is because class actions aggregate many potential claims into one lawsuit, and in many cases an unfair or unconstitutional class certification ruling cannot be appealed until after an expensive trial on the merits. Defendants face the risk of a single judgment in the tens of millions or even billions of dollars, simply because a state court judge has rushed to certify a class without proper review. The risk of a single, bankrupting award often

forces defendants to settle the case with sizable payments even when the defendant has meritorious defenses. As one federal court explained, "The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low. These settlements have been referred to as judicial blackmail."

This "judicial blackmail" imposes increased costs on the economy, causing higher prices and lower wages (along with the enrichment of those attorneys who brought the weak claims in the first place). When litigation costs become too unpredictable, the effect will be to dissuade investment, discourage entrepreneurship, increase the costs of risk planning, and threaten the core activities essential to our economy.

Efforts to Reform Class Actions. Congress has attempted to reform the class action rules for several years despite strong resistance from many trial lawyers who have been enriched by the current system. The House has held several hearings and passed a class action reform bill in four consecutive Congresses, including the 108th. The Senate Judiciary has held three hearings in recent years, reporting favorably a bipartisan bill the 106th Congress. Most recently, on April 11, the Senate Judiciary Committee reported the Class Action Fairness Act (S. 274) after a favorable, bipartisan vote of 12-7, with Senators Feinstein and Kohl joining all Republicans in supporting the bill.

At the Committee markup for S. 274, a section dealing with "mass actions" — devices used by some States that are roughly parallel to class actions — was stripped on the condition that it would be modified and put back into the bill before floor consideration. Pursuant to that earlier agreement, Senators Hatch, Grassley, Specter, Kohl, and Feinstein since have agreed to the modified language and replaced it in Section 4 of the bill. The modified language was wrapped into the Committee-reported bill and introduced as S. 1751.

Bill Provisions

Section 1 establishes the "Class Action Fairness Act of 2003" as the short title.

Section 2 sets forth findings, including: (1) class actions are a valuable part of the legal system; (2) recent abuses of the class action system have undermined justice and adversely affected interstate commerce; (3) class members often receive little or no benefits from class actions; and (4) abuses of the class action system undermine justice by keeping cases of national importance out of Federal court and enable some state courts to bind residents of other States. The purpose of this bill is to assure fair and prompt recoveries for class members with legitimate claims, to ensure Federal court consideration of interstate cases of national importance, and benefit society by encouraging innovation and lowering prices.

Section 3 sets forth a "Consumer Class Action Bill of Rights" to help ensure that class actions do not hurt their intended beneficiaries — class members. That bill of rights includes the following provisions:

— Federal courts must hold a hearing and find that the settlement is fair before approving any class action settlement in which class members receive non-cash benefits (such as coupons) or in which they must expend money to get benefits.

— Federal courts may not approve any settlement that provides for greater payments to certain class members based solely on where they reside.

— Federal courts may not approve a settlement that provides for a greater payment to the class representative — also known as a "bounty" — unless it compensates reasonable time and costs incurred.

— All class notices must be written in "plain, easily understood language" so that class members receive all material information about the case before deciding whether to participate in a class action or a settlement; and

— Defendants must notify appropriate federal and state authorities of all proposed settlements to ensure an additional layer of independent oversight.

Section 4 gives federal courts original jurisdiction over class action lawsuits in which the matter in controversy:

— Exceeds the sum or value of $5 million;

— Includes 100 or more putative class members, and

— Either (a) any member of the class of plaintiffs is a citizen of a different State from any defendant; (b) any member of a class of plaintiffs is a foreign State or a citizen or subject of a foreign State and any defendant is a citizen of a State, or (c) any member of a class of plaintiffs is a citizen of a State and any defendant is a foreign State or a citizen or subject of a foreign State.

The Committee adopted an amendment now known as the Feinstein Compromise that provides special jurisdictional rules for class actions filed against primary defendants in their home State. That language, found at Section 4(a)(3)-(5), provides:

— If at least two-thirds of putative class members are citizens of the defendant's home State, then S. 1751 does not extend federal jurisdiction to the suit;

— If fewer than two-thirds but greater than one-third of putative class members are citizens of the defendant's home State, then the federal court has the discretion to accept or refuse jurisdiction, pursuant to five statutory factors aimed at determining the overall need for federal jurisdiction; and

— If fewer than one-third of putative class members are citizens of the defendant's home State, then federal jurisdiction is proper because the case is predominantly interstate and may involve the laws of multiple States.

Section 4 also includes several provisions limiting federal jurisdiction:

— S. 1751 does not extend federal diversity jurisdiction to class actions in which the primary defendants are States, state officials, or other governmental entities against whom the district court may be foreclosed from ordering relief;

— S. 1751 does not extend federal diversity jurisdiction to class actions in which the number of plaintiffs is fewer than one hundred; and

— S. 1751 does not apply to securities-related class actions or state law-based class actions regarding the internal affairs of a business enterprise.

At the Committee markup for S. 274, a section dealing with "mass actions" — devices used by some States that are roughly parallel to class actions — was stripped on the condition that it would be modified and put back into the bill before the bill was considered on the floor. Pursuant to that earlier agreement at markup, Senators Hatch, Grassley, Specter, Kohl, and Feinstein have since agreed to the modified language and replaced it in Section 4.

— S. 1751 states that a "mass action shall be deemed to be a class action" where "monetary relief claims of 100 or more persons are proposed to be tried jointly in any respect on the ground that the claims involve common questions of law or fact."

— S. 1751 will not apply to mass actions where "all of the claims in the action arise from a single sudden accident that occurred in the State in which the action was filed, and that allegedly resulted in injuries in that State or in [continguous] States."

— S. 1751 also does not apply to mass actions where the claims are joined by motion of a defendant or when brought on behalf of the general public pursuant to a state statute authorizing that case.

— S. 1751 also would not permit any transfer of mass actions under the multidistrict litigation rules without a request by a majority of plaintiffs.

Section 5 establishes the procedures for removal of interstate class actions over which the Federal court is granted original jurisdiction in Section 4, above. Removal may occur without the consent of any other party, a provision that overrules federal caselaw requiring consent of all parties on the same side of a lawsuit. Consistent with Section 4, above, securities lawsuits and state law-based class actions regarding the internal affairs of a business enterprise are excluded from this provision. Section 5 also ensures that removal is available within 30 days of notice that the case may be eligible for removal.

Section 6 directs the Judicial Conference of the United States to prepare a report with recommendations on the best practices that courts can use to ensure fairness in class action settlements.

Section 7 provides that amendments made by S. 1751 shall apply to any civil action commenced on or after the date of enactment of the bill.

Administration Position

The Administration issued a SAP in support of H.R. 1115, the House bill that is very similar to S. 1751. As of press time the Administration had not released a SAP on S. 1751.

Cost

The Congressional Budget Office estimates that the increased number of class actions in federal court will cost $6 million per year and would impose no costs on state, local, or tribal governments.

Other Views

Senators Leahy, Kennedy, Biden, Feingold, Schumer, Durbin, and Edwards filed minority views in relation to S. 274. Those views, available at pp. 73-89 of the Committee Report, are summarized below, along with responses from the Committee. The "mass actions" agreement discussed above does not substantially affect the other views filed.

- S. 274 (now S. 1751) will send most state class actions into Federal court and deprive state courts of the power to adjudicate cases involving their own laws. The bill therefore infringes upon States' sovereignty.

  The Committee has responded that there is no evidence for this assertion, and that it is the present system that infringes upon state sovereignty rights by promoting a "false federalism" whereby some state courts are able to impose their decisions on citizens of other States regardless of their own laws. (See also Committee Report response at pp. 51-54; 59-60.)

- S. 274 (now S. 1751) unduly expands federal diversity jurisdiction at a time when courts are overcrowded; concerns about local court prejudice are overblown.

  The Committee has responded that state courts have experienced a much more dramatic increase in class action filings and have not proven to be any more efficient in processing complex cases. The Committee further responds that federal courts have greater resources to handle most complex, interstate class action litigation, and are insulated from the local prejudice problems so prevalent under current rules.

- The consumer bill of rights provisions are favorable, but do not do enough to battle abuses in the class action system.

  The Committee has responded that the consumer bill of rights discussed above and at length in the Committee Report will benefit consumers greatly.

- The bill should contain special carve-outs for civil rights cases, state consumer protection cases, state environmental protection cases, gun liability cases, and tobacco cases.

  The Committee has responded that proponents of such carve-outs have never established that state courts would provide more fair or expeditious treatment for these claims. (Committee Report response at pp. 55-57.)

- S. 274 (now S. 1751) will cause federal cases that do not satisfy the requirements of the Federal Rules of Civil Procedure to be dismissed. If re-filed in state courts, they will just be removed and dismissed again. This "merry-go-round" deprives injured parties of access to the courts.

  The Committee has responded that it makes no sense to allow a class action to proceed in state court after a federal court has determined that the class cannot be certified, because doing so would turn federalism upside-down. Litigants can always re-file in state court on an individual basis. (Committee Report response at pp. 64-65.)

Possible Amendments

Based on votes in the Judiciary Committee and on views expressed in the Committee Report, Senators should be prepared for several amendments on the floor.

Carve-out amendments. Several Judiciary Committee Democrats offered amendments in committee to create special carve-outs for certain types of cases, such as environmental, gun, civil rights, tobacco, and consumer protection. All amendments were defeated on a bipartisan basis. The Committee urges opposition to any carve-out amendments because federal courts have more resources and are better equipped to handle complex, interstate class action cases. While it is true that federal courts typically apply the rules of civil procedure more carefully and meticulously than some state courts, there is no evidence that federal courts are any less fair or capable. The Committee points out that federal courts are often the forum of choice for civil rights and tobacco litigants.

"Merry-Go-Round" amendment. Senator Feingold offered an amendment in Committee to permit cases that fail to meet federal class action certification requirements to proceed in state court if state court class certification rules could be met. The amendment would address the "merry-go-round" charge leveled by some critics of the bill. The amendment was defeated in Committee on a bipartisan basis. The Committee urges opposition to this amendment because the amendment would gut the bill essentially by preserving the status quo. This bill moves substantial interstate litigation into federal courts where it belongs.

Feinstein Substitute amendments. Democrats may offer a variety of amendments to weaken the compromise agreed to in Committee. For example, they may offer amendments to keep more cases in state courts and to remove the "primary defendant" requirement so that more cases are subject to the criteria embodied in the Feinstein amendment adopted in Committee (in Section 4 of the bill). The Committee urges defeat of these amendments because the compromise worked out with Senator Feinstein was a carefully crafted agreement that draws appropriate lines to ensure that large, substantially interstate class actions are in federal court.

Leahy/Breaux Substitute amendment. Senator Leahy or Breaux (or another Democrat) may offer a substitute amendment to the bill. The Leahy substitute would keep cases in state court if defendants do "substantial business" in the State. The Committee urges defeat of this amendment because it would preserve the status quo and fail to solve any of the problems that form the rationale for this bill. The Breaux substitute, the Committee states, would turn diversity jurisdiction on its head by allowing States to adjudicate traditionally federal cases between citizens of two different States. Nor would either substitute provide substantial protection against unjust coupon settlements.